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C O N F I D E N T I A L SECTION 01 OF 03 ASUNCION 000951

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SUBJECT: PARAGUAY'S NEW CENTRAL BANK PRESIDENT ON IMF, BANK
REFORM, AND OPENNESS TO OTA TECHNICAL ASSISTANCE

Ref: ASUNCION 00939

Classified By: Ambassador John F. Keane for reasons 1.4 (b)
and (d)

Summary

1. (C) Summary: In an introductory call on July 20 with Monica Perez, Paraguay's new Central Bank President, the Ambassador described the in-country programs of Treasury's Office of Technical Assistance (OTA), introduced OTA's debt advisor, and extended the offer of OTA's banking team to do an assessment with a view toward possible future technical assistance. Mr. Perez was very receptive to the offer of assistance, and cited the superintendent of banks to include bank resolution and asset management, central bank restructuring, banking regulation and inflation modeling as areas of interest. Ms. Perez confirmed that the GOP is seeking a follow-on IMF program. She told the Ambassador that the GOP would seek a similar framework of quantitative targets, but said the GOP, including President Duarte, does not want a heavy legislative agenda. Ms. Perez conveyed confidence and a command of the many challenges she faces. The combination of a fresh outlook, technical competence, and backing from the President present the USG with an excellent opportunity to help shape with OTA assistance the direction of financial sector reform in Paraguay. End summary.

Economic Reform and US Support

2. (U) On July 20, the Ambassador, Econ Chief and the Resident Debt Advisor from Treasury's Office of Technical Assistance (OTA) met with Monica Perez, the new President of Paraguay's Central Bank (BCP). The Ambassador requested the meeting as an introductory call, to introduce Ms. Perez to the work of OTA's various advisors (debt, budget, taxation and enforcement), and to communicate an offer from OTA's banking team to undertake a needs assessment for the BCP to identify areas of possible collaboration. Ms. Perez was open and forthcoming, and enthusiastically welcomed OTA's offer of assistance.

3. (U) The Ambassador opened the meeting by underscoring the investments the US has made in Paraguay based on President Duarte's support for economic reform. He described the substantial commitment on the part of OTA, with three resident, and one intermittent, advisors from four of the five OTA teams. He described the range of topics covered by the banking team, and told Ms. Perez that an assessment mission could take place as soon as August if she were interested. The Ambassador described the work of OTA's Resident Enforcement Advisor, who was unable to participate in the meeting, and encouraged Ms. Perez to continue fostering cooperation among the various entities involved in combating money laundering.

Debt Issues

4. (SBU) Patricia Bacchi, OTA's resident debt advisor, described her work, one focus of which has been the drafting of a general debt law to make it possible for the Finance Ministry to issue bonds and to encourage the development of a domestic capital market. Perez said she was happy to hear of progress on a draft debt law, and suggested that we contact Finance Minister Bergen to underscore the importance of creating a debt management framework. She also agreed that a quantitative debt policy based on a debt sustainability model was something Paraguay needed to develop, in particular as a tool to fend off

unrealistic spending plans.

IMF Program

15. (C) Ms. Perez confirmed that the GOP is seeking a follow-on IMF program. She told the Ambassador that the GOP would seek a similar framework of quantitative targets, but said the GOP, including President Duarte, does not want a heavy legislative agenda. She argued that legal changes are not in the executive's control, and said that too many countries are "victims" of the IMF's tendency to seek significant legislative changes. While qualifying her appreciation of the political scene by noting her 13-year absence from Paraguay, she pointed out that this next year will probably be a difficult time to work with Congress given municipal and internal party elections on the schedule, as well as the very fragile alliance that was formed to elect the current Congressional leadership (reftel).

Legislative Obstacles...And Risks

16. (C) She cautioned that bad outcomes can result from seeking major legislative changes, and gave as an example the public banking law working its way through Congress (with damaging changes to the version submitted by the executive). She also mentioned the banking law submitted in December 2004, the passage of which by June 30, 2005 was a (now missed) performance criterion of the current IMF program. No action has been taken on the law, which was drafted with the help of the World Bank. Ms. Perez characterized the law as flawed, and as a law championed by the Ministry of Finance rather than by the BCP. She described how President Duarte told Pamela Cox, the World Bank's Vice President for Latin America and the Caribbean, that the banking law would not be passed as it is, although he said he was committed to a banking law in some form. Ms. Perez prefers a law that "reflects Paraguay's realities" and that is drafted after a careful review of a number of laws, including the BCP charter.

17. (C) In that context, she referred to an agreement within the current economic team to give each member control of issues in his or her area. She criticized, without naming names, various "actors" in the government, often advisors with no individual responsibility, who push initiatives like a recent draft law, now shelved at least temporarily, that would have allowed for easy refinancing of non-performing loans. The economic team, led by Finance Minister Bergen, agrees that all new initiatives must pass through the team.

Structure of the Central Bank

18. (C) In reference to the draft banking law, Ms. Perez questioned the proposed structure of the central bank, and said she had discussed her misgivings with the IMF and World Bank. She said that the draft law contemplates a semi-independent superintendent of banks, but without clear legal protections for the Central Bank President, and without a clear line of responsibility. The fear of potential liability would lead to a defacto centralized system. Ms. Perez identified the superintendent of banks as a source of significant concern. She questioned the quality of the information reaching the BCP's Board of Directors, and complained that the vast majority of her time is consumed by supervision issues, including with the financial institutions in liquidation, leaving little time to focus on policy. Ms. Perez expressed her strong personal preference for a bank that is decentralized, but with cross-checking, and expressed hope that US technical assistance could involve someone from the Federal Reserve to advise on these issues.

Welcoming OTA Banking Technical Assistance

19. (U) Ms. Perez enthusiastically welcomed the offer of technical assistance, and was pleased to learn that OTA provides its assistance on a grant basis. She signaled her disapproval of the fact that roughly half of the second phase of a World Bank financial sector loan yet to be signed was slated for the payment of consultants. Perez has heard that Taiwan may be interested in providing banking technical assistance, and has already requested technical assistance from the IMF, but said she would prefer US expertise. While candidly acknowledging that the BCP needs help in most areas, she said her priorities are: the superintendent of banks (including bank resolution and asset management), central bank restructuring, a review of

banking legislation with the view to eventually drafting a new banking law, and technical assistance with inflation modeling to inform monetary policy.

Comment And Bio Note

10. (C) Ms. Perez conveyed confidence and a command of the many challenges she faces. She was remarkably candid and open with the Ambassador, and acknowledged that she faces resistance from members of her Board of Directors and some other actors within the government, and faces constraints such as an extremely rigid budget. Her close family ties to the President and his recent public statements suggest that she has his confidence and strong support. The combination of a fresh outlook, technical competence, and backing from the President present the USG with an excellent opportunity to help shape with OTA assistance the direction of financial sector reform in Paraguay. Having studied in Germany and worked abroad for several years, Perez shows directness and discipline not common in Paraguay. Her skills and no nonsense approach will make her a formidable player as long as she retains Duarte's support and would appear a key ally on USG reform priorities.

KEANE